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August 31, 2010

Ms. Jennifer J. Johnson

Secretary

Board of Governors of the Federal Reserve System

20th Street and Constitution Ave NW

Washington, DC 20551

Re: **Docket No. R-1386**

Dear Ms. Johnson:

I am contacting you from Woodstock Institute to provide several recommendations to modernize the Community Reinvestment Act (CRA). These recommendations include:

- Expand the scope of the Act to include other types of financial institutions in addition to depositories;
- Change the current definition of assessment areas;
- Improve the service test;
- Improve data disclosure requirements for small business lending;
- Improve the existing ratings and incentive structure.

Woodstock Institute is a leading nonprofit research and policy organization in the areas of fair lending, wealth creation, and financial systems reform. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. Its key tools include applied research, policy development, coalition building, and technical assistance.

CRA regulations have remained nearly unchanged since they were last modernized in 1994. Over the last 16 years, however, the financial landscape has changed significantly, and two key factors have diminished the opportunity for the CRA to be most effective: the increasing role of financial institutions (such as mortgage companies, insurance companies, credit unions, and securities companies) not currently covered by the CRA; and, the consolidation of depository institutions traditionally covered by the CRA. As mortgage companies expand and insurance and securities companies changed to offer many of the same products once offered primarily by depositories, the CRA has not been updated to ensure that these institutions effectively meet the financial needs of the communities in which they are located, including low-wealth communities and communities of color. Likewise, in the past, the CRA has been most effective as a tool to ensure that merged institutions live up to their community investment obligations. The past decade has seen considerable industry consolidation, resulting in fewer merger opportunities for public input. As a result of the ongoing financial and foreclosure crisis,

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the few large mergers that have occurred were the result of financial insolvency and have taken place on an emergency basis, with no public input for consideration of the merged institutions' community investment commitments.

With the passage of the Dodd-Frank Act and the creation of a Consumer Financial Protection Bureau, it is important to examine and improve strategies to ensure equitable access to responsible and fairly priced products. The CRA has proven to be one of the best tools to achieve this goal, but it can continue to do so only if the following changes are made.

Expand the Scope of CRA to Include Mortgage Companies, Brokers, Insurance Companies and Others

The percentage of assets deposited in banks and thrifts, which have community reinvestment obligations under CRA, has declined dramatically, reducing the effectiveness of the CRA. When the CRA was enacted in 1977, households held 25 percent of their financial assets at CRA-regulated institutions. By 2007, that share had declined to 15 percent.¹ As financial assets migrate to other types of institutions such as mortgage companies, insurance companies, credit unions, and securities companies and as these institutions take on a greater role in providing financial products to consumers, it is critical that we expand the scope of CRA to these types of institutions to ensure that it remains relevant and effective at encouraging financial services providers to meet the needs of low-wealth people and communities.

Mortgage Companies and Brokers

Where there was once a strong connection between local bank branches and mortgage lending, mortgage lending is now much more likely to occur through large mortgage banking affiliates or mortgage brokers that currently have no community reinvestment obligation. In 2009, Woodstock Institute and a collaboration of similar organizations in four other states documented that, in low- and moderate-income communities, depositories with CRA obligations originate a far smaller share of higher-cost loans than lenders not subject to CRA. This report also finds that lenders covered by CRA are much less likely to make higher-cost loans in communities of color than are lenders not covered by CRA.² Going forward, it is critical that mortgage companies and brokers that account for such a large share of the mortgage market be subject to the CRA and the transparency and accountability that the CRA provides.

Insurance Companies

Insurance redlining results in disparate access to affordable insurance products in low-wealth communities and communities of color. For nearly 30 years, Woodstock Institute and others have called

¹Avery, Robert, Marsha Courchane, and Peter Zorn. "The CRA within a Changing Financial Landscape." 8 Apr 2009. Web. 30 July 2010.

²*Paying More for the American Dream III: Promoting Responsible Lending to Lower-Income Communities and Communities of Color.* Woodstock Institute et al, 2010. Web. 23 July 2010.

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for the establishment of a comprehensive insurance disclosure requirement, as well as an affirmative obligation of insurance companies to serve low-wealth communities and communities of color. Under the Dodd-Frank Act, a new Federal Insurance Office will be established to monitor the provision of insurance and to collect and disseminate data on the insurance industry. We believe that, using these data to inform the process, insurance companies should be subject to community reinvestment obligations similar to other financial institutions.

Credit Unions

Despite credit unions' role in providing financial services to low-wealth people, a 2003 Woodstock Institute report found that they serve a much lower percentage of lower-income households than they do middle and upper-income households.³ Credit union members receive significant benefits in the form of higher interest payments for share accounts, lower rates on loans, and less expensive basic financial services. Those benefits are directly subsidized by federal and state tax exemptions and, as such, the credit unions that receive those benefits should have quantifiable community reinvestment obligations under the CRA.

Securities Companies

Access to stocks, mutual funds and other wealth-building securities provides families with the option to assume a level of risk appropriate to their investment goals, and in many cases, build long-term wealth. According to the 2007 Survey of Consumer Finances, only 9.4 percent of families headed by people of color directly hold stocks, compared to 21.4 percent for families headed by white people. Many securities companies operate nationally and some do considerable business with the federal government and should be required to have some form of community reinvestment obligation to address this persistent gap in access and opportunity.

Geographic Coverage and the Definition of Assessment Areas

Currently, the CRA does not require banks to serve the financial needs of low-wealth people in all of the communities where they actually lend—only where they have bank branch locations. However, new types of financial institutions such as online banks have emerged and others, such as insurance companies and credit card banks, have expanded to provide other products and services. In light of these new and changing delivery channels, the existing designation of these CRA assessment areas based on branch location is insufficient and does not capture the complete market presence of a financial institution for the purposes of determining that institution's reinvestment activity. Large online banks gather deposits and make mortgage loans across the country, but have a physical presence only where their headquarters are located. Insurance companies selling financial products currently have a community reinvestment obligation only where they are headquartered, even though many have thousands of agents that sell and

³Jacob, Katy, Malcolm Bush, and Daniel Immergluck. *Rhetoric and Reality: Many Mainstream Credit Unions Do Not Serve Lower Income People*. Chicago, IL: Woodstock Institute, 2002. Web. 22 July 2010.

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service those products.⁴ Credit card banks may have a headquarters in Delaware or South Dakota, but provide personal and business credit lines throughout the country.

There is also evidence that financial institutions regulated by the CRA have different lending patterns inside and outside of their assessment areas. In the seven MSAs examined by Woodstock Institute and a collaboration of similar organizations, CRA-regulated institutions lending outside of their CRA assessment areas had a much higher percentage of higher-cost loans than they did when lending within their assessment areas. In the five MSAs examined, higher-cost loans originated in low- and moderate-income tracts by depositories acting outside of their assessment areas exceeded the higher-cost rates from independent mortgage firms.⁵

To ensure that all of these types of financial institutions are meeting the credit needs of their entire market area, including low-wealth communities and communities of color, the CRA assessment areas must be changed to reflect how these financial institutions do business. Assessment areas should be defined as any state, metropolitan area or rural county where that institution maintains retail offices or is represented by an agent or has at least a 0.5 percent market share in housing-related loans, securities, insurance, or any other financial instrument designated as CRA-eligible for the purposes of establishing an assessment area.

Modernizing the Service Test

Woodstock's work on the implementation of the CRA service test has shown that the implementation of the test is imprecise and inconsistent. It has also shown that the additional data necessary to aggressively implement the service test is already collected and frequently used by some of the largest financial institutions.

While the distribution of some financial products and services is decentralized or sold through networks of agents or brokers, bank branches still play an important role in providing access to retail banking services, such as basic checking and savings accounts. A modernized CRA should include a renewed obligation to meet the transactional account needs of low-wealth people and communities of color. Currently, federal banking regulators count the physical presence of bank branches in underserved communities as a measure of meeting the transactional needs of low-wealth communities—a measure identified in a 2007 Woodstock report on the implementation of the service test as inconsistent and unreliable.⁶ Instead, the CRA should be modernized to ensure that those branches are actually providing services to low- and moderate-income people, and that those services are fairly priced.

⁴Jacob, Katy. *Reinvestment Alert 24: CRA, Financial Modernization and the Policy Implications of Insurance Company*. Chicago, IL: Woodstock Institute, 2003. Web. 22 July 2010.

⁵*Paying More for the American Dream III: Promoting Responsible Lending to Lower-Income Communities and Communities of Color*. Woodstock Institute et al, 2010. Web. 23 July 2010.

⁶Smith, Geoff, Malcolm Bush, and Nathan Pauvey. *Reinvestment Alert 31 - Measuring the Provision of Banking Services for the Underbanked: Recommendations for a More Effective Community Reinvestment Act Service Test*. Chicago, IL: Woodstock Institute, 2007. Web. 22 July 2010.

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The fact that a branch is located in a low-wealth community does not necessarily mean that the bank is offering retail products appropriate for low-wealth consumers or effectively reaching those consumers with its existing products. In fact, some low-wealth consumers often choose to bank near employment centers, rather near their home. In either case, the physical location of a branch is an insufficient measure of how well a bank is serving low-wealth consumers.

In the past, federal bank regulators have argued that they lack the data to evaluate banks' performances under the service test. However, Woodstock research has shown that these data exist and are used by banks as part of the regular monitoring of their businesses.⁷ Banks regularly collect a variety of indicators on account holders and transactions including such critical variables as census tract location, account holder, number of new accounts opened, age of account, and percent of bank income generated by fees. Such data would give a useful picture of the degree to which banks are actually providing bank services to lower-income communities. While the distribution of bank branches, the only quantitative indicator currently used in the service test, is an important indicator, it is insufficient because it is only a proxy for the actual delivery of bank services.

These data on service delivery to low- and moderate-income people, the unbanked, and the underbanked should also be made public. Analysis of public data made available through the Home Mortgage Disclosure Act (HMDA) and the CRA have proved critical in understanding mortgage lending patterns and small business lending markets. These data have allowed researchers and advocates to highlight gaps in access to credit, expose disparate lending patterns, and work with financial institutions to improve lending levels in low- and moderate-income communities. Similar data on bank services would serve an important role in adding necessary transparency to the provision of bank products to lower-income communities and provide an incentive for banks to improve their performance.

Improving Small Business Lending Data Disclosure

Expanding data disclosure for small business loans is also critical to ensuring that financial institutions are working to build the economy and create jobs in the communities where they do business and to understanding what gaps exist in access to small business finance. The current small business data disclosure requirements do not include important demographic information and apply only to the largest financial institutions, leaving out many community banks, niche lenders, and small de novos that have emerged as important players in the small business lending market. Additionally, data are not available at the loan level making analysis difficult.

We recommend that the existing small business lending disclosure requirements be expanded to include the race and ethnicity, as well as the gender, of borrowers and that lending to women. The reporting requirement threshold should also be lowered to include financial institutions with more than \$250 million in assets and include loans made in non-metropolitan areas. Information should be collected on the type and purpose of financing being provided. Also, data should be made available at the loan level.

⁷Smith, Geoff, Sarah Duda, and Malcolm Bush. *Benchmarking Branch Outcomes: Using Available Data to Analyze and Improve the Delivery of Retail Bank Services to Low-Wealth Communities*. 2009. Web. 22 July 2010.

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As far back as 1999, Woodstock Institute has called for the collection of race and gender data for small business loans, but, to date, the Federal Reserve has not taken this important step in eliminating disparate treatment and discrimination in small business lending.⁸

We also recommend that regulators use this improved data disclosure to determine a financial institution's small business lending activity to women, and in low-wealth communities and communities of color as part of its CRA performance evaluation.

Increasing Transparency of Community Investment Goals

Currently, financial institutions are assessed under the Community Reinvestment Act for their ability to meet the credit and financial services needs of low-wealth communities in their market area. However, there is no objective measure of what these needs are, so it is difficult to understand how well financial institutions are performing. We recommend the establishment of an interagency survey of financial services needs, as well as the public disclosure of individual financial institutions community investment plans. These two components will work together to ensure that all the financial services needs of a specific market area are being met broadly, and that individual financial institutions are living up to their stated community investment goals.

Developing New Mechanisms to Encourage CRA Compliance

The consolidation of the banking and thrift industry during the past decade, combined with the rapid acquisition of distressed institutions during the ongoing financial and foreclosure crisis, has resulted in fewer opportunities for actionable public scrutiny of a bank's CRA performance. First, there are far fewer mergers of healthy institutions. When mergers and acquisitions of small and regional banks and thrifts were commonplace, there were considerably more opportunities for public scrutiny of CRA performance, either through regulatory letters during a public comment period or testimony at a public hearing. Second, many of the mergers that have occurred in recent years have taken place on an emergency basis to facilitate the transfer of a distressed financial institution to a healthier one. Almost all of these emergency mergers have occurred with no opportunity for public comment.

We recommend creating several new compliance incentives for the CRA. In cases where a bank receives a low satisfactory or lower rating in one or more assessment areas, they should be required to prepare and submit a public improvement plan. For financial institutions that still do not improve, we recommend that they be unable to sell mortgages to the GSEs, be ineligible to contract with federal agencies, and/or pay any applicable fines to a national reinvestment fund. We also recommend that the CRA give regulators the ability to provide favorable consideration for financial institutions that provide support for national investment funds, work with local organizations to develop local or regional CRA commitments, develop new affordable small dollar loan products, or provide increased equity investments in CDFIs.

Finally, the public comment process needs to be substantially improved.

⁸Bush, Malcolm. "Comments on Regulation B Proposed Rule Docket No. R-1008." 3 Nov. 1999. Web. 22 July 2010.

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We recommend at least a 60 day comment period for all applications to merge or expand. In the event of an emergency acquisition initiated by a bank regulator, we request that the regulator hold public hearings in at least one of the financial institution's assessment areas and require that the acquiring institution develop a CRA plan to effectively invest in the acquired institution's assessment areas.

Conclusion

Based on nearly 40 years of research, policy development, advocacy, and technical assistance in the field of community reinvestment, Woodstock Institute is in a unique position to provide substantive recommendations to improve the CRA. Many of the recommendations provided in this letter require a legislative change to the Act and fall outside the scope of the regulatory comment process. We hope that the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, as well as the regulators of credit unions, insurance companies and securities companies, will lend their strong support to the adoption of these necessary legislative changes.

Sincerely,

 Dory Rand
President

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